JULY 14, 1986 THREE DOLLARS FIFTY CENTS

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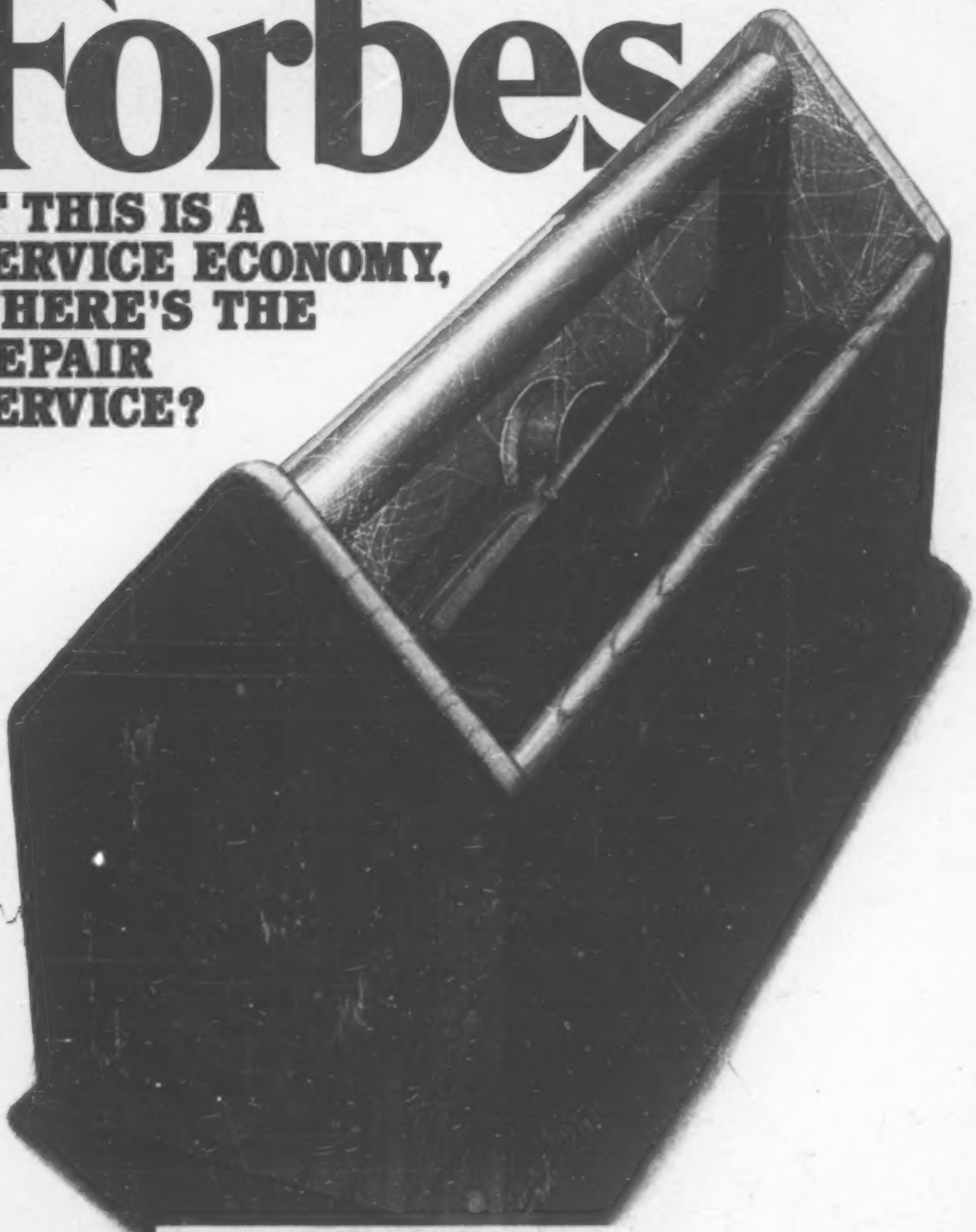
Forbes

IF THIS IS A SERVICE ECONOMY, WHERE'S THE REPAIR SERVICE?



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40 *Rochester Tel's Alan Hasselwander*

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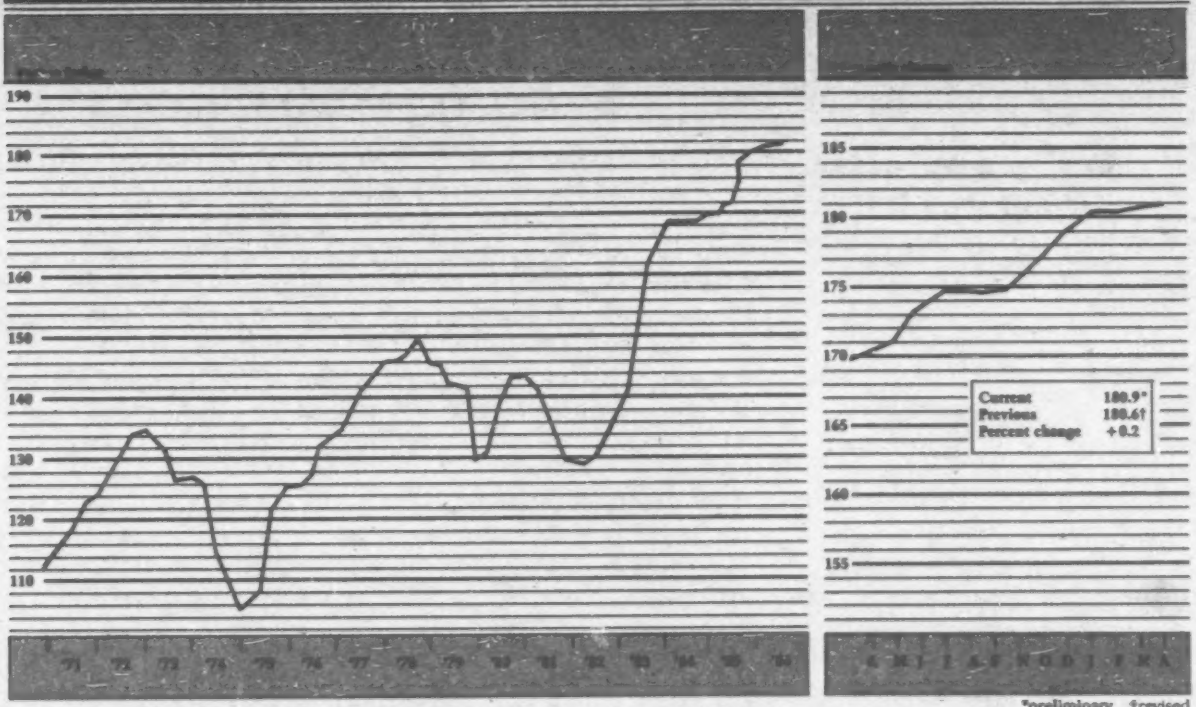
The Forbes Index



*preliminary †revised

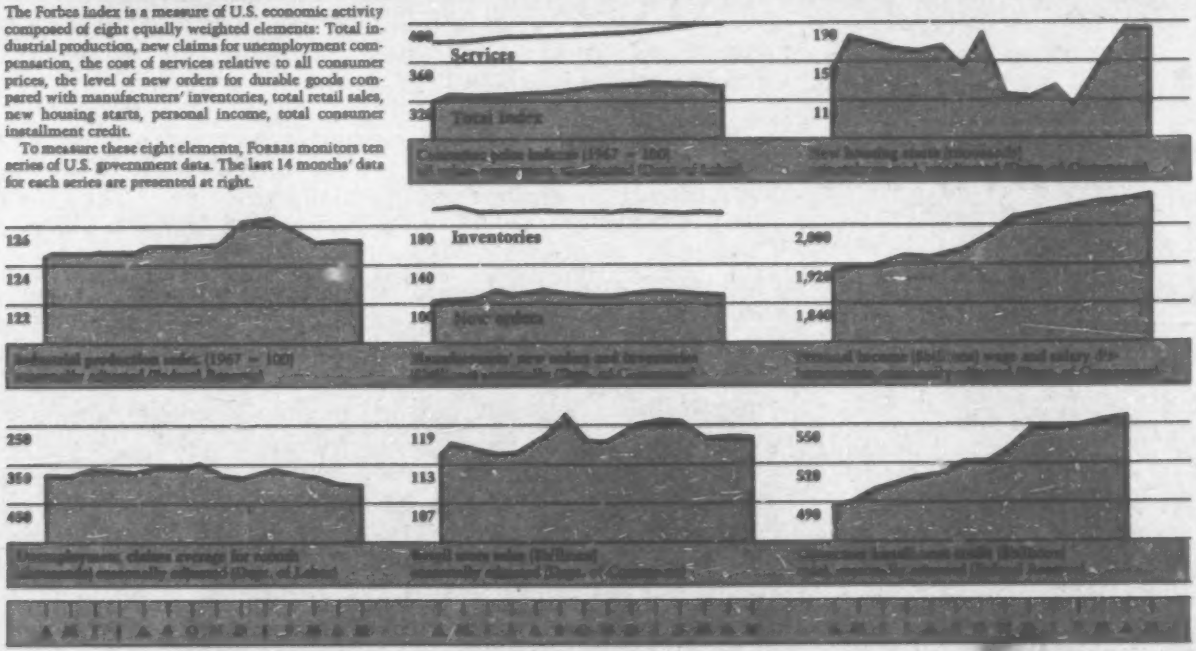
Behind the shiny facade. The Forbes Index gained 0.2% overall during the latest reporting period, but several Index components declined. Personal income rose 0.2%, and consumer installment credit, a reflection of auto and appliance sales, rose 0.8%. Yet retail sales, stronger in January and February, slipped by 0.7% from April to May. And manufacturing still isn't doing well. Industrial production declined by 0.5%.

The lackluster economy is having an impact on jobs, as evidenced by the 1.7% jump in new unemployment claims, the largest month-to-month increase since February. Although new housing starts for May were 11.5% higher than for May of last year, they were off nearly 0.1% from April.

The Forbes Index Components

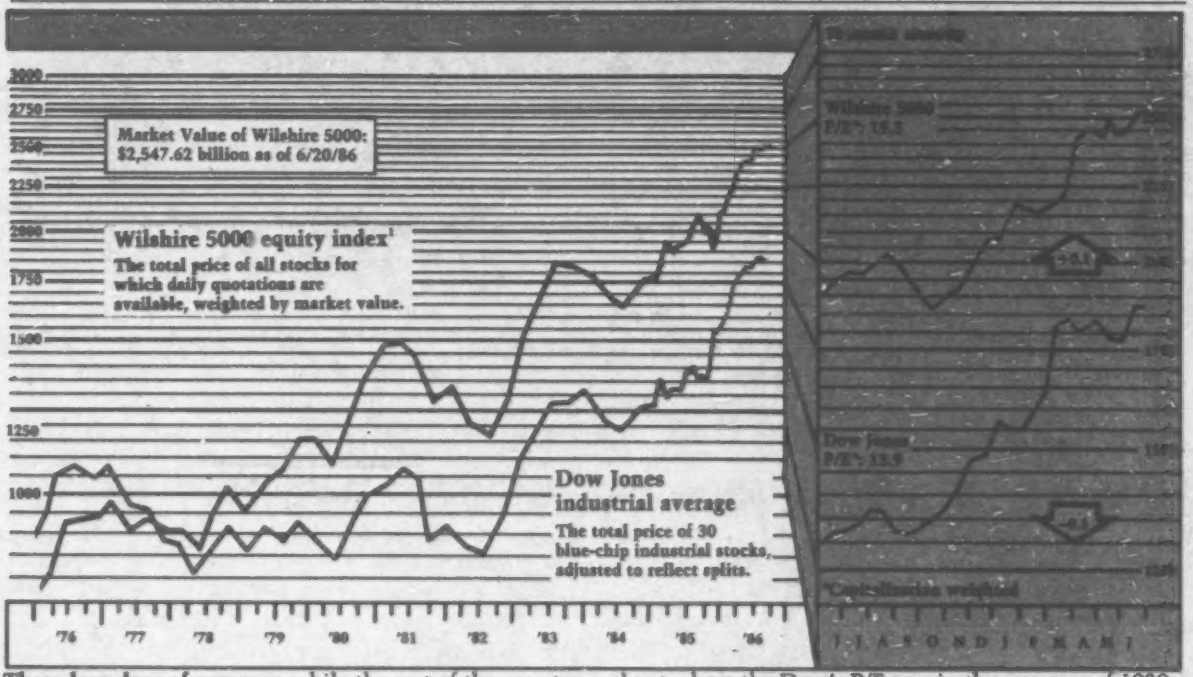
The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, Forbes monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.



The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



These lazy days of summer, while the rest of the country is off on vacation, are when strange things can happen on Wall Street. Over three of the last six summers the Wilshire index made double-digit swings. The wildest summer of the lot was in 1980, when the Wilshire gained 16.7%. The second-best gain, 15.4%, came in the summer of 1982. When the August 1982 rally began, the market sold at only 7.1 times most recently reported earnings. Now the P/E multiple on the Wilshire is 18.3. That's about where the Dow's P/E was in the summer of 1929.

The Dow industrials opened the recent two-week period at an alltime high but ended the first trading day with a near-record 46-point loss. Investors then spent the next nine trading days bidding the Dow back up. The 30-stock Dow ended with a 0.3% loss while the Wilshire index posted a 0.1% gain. Big Board shares gained 0.5% on rather slow volume, while Amex issues were up 0.4%. Nasdaq shares fell 0.8%.

Closeup On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Value Line[2]	Dow Jones Industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
In last 4 weeks	1.7	1.0	1.1	2.6	1.3	1.3
In last 52 weeks	30.0	17.7	6.9	28.9	24.8	37.5

Stock performance based on six key investor parameters

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
In last 4 weeks	1.0	2.1	-0.1	2.1	0.4	0.5	1.0	1.8	2.5	2.2	2.7	0.1
In last 52 weeks	30.3	39.5	75.4	31.0	33.0	40.9	24.5	33.3	68.8	28.2	40.3	34.2

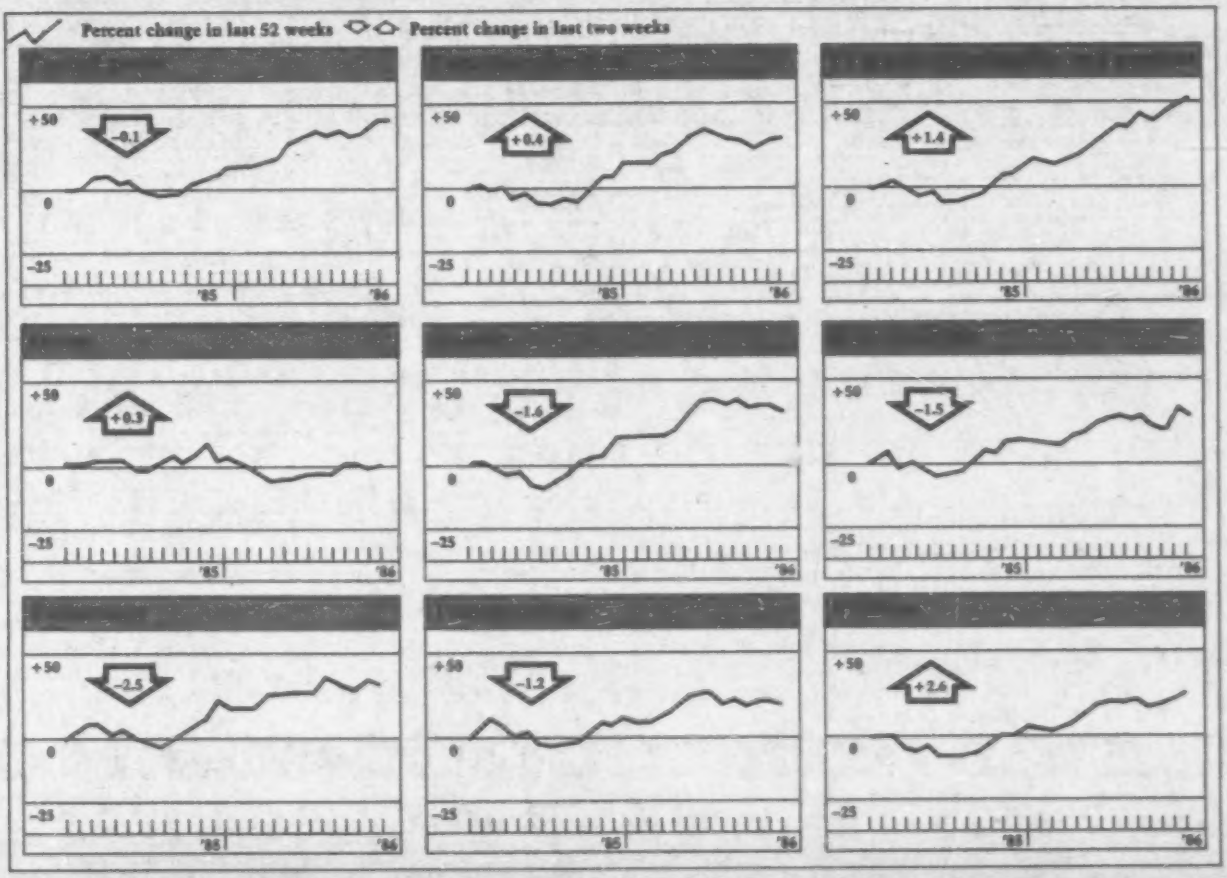
[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created.
[2]Based on sales.
[3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable.
[4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 6/20/86. Prepared by Wilshire Associates, Santa Monica, Calif.

Guy Peach

Where The Action Is

Where's the service? At the top of the charts. Wall Street is hot for consumer nondurables companies, among which are a lot of service businesses, from McDonald's to Great Atlantic & Pacific Tea. With a 52-week gain of 49%, the consumer nondurables (which also include drug manufacturing, another current favorite) outperformed the Wilshire index (up only 30%) and the remaining eight sectors. In consequence, consumer nondurables sell at the highest premium of the lot, 17.3 times estimated 1986 earnings. But beware the flip side. Investors often react sharply when stocks such as these report disappointing news. During the last two weeks, for example, warehouse retailer Price Co. fell nearly 15% in response to first-quarter earnings that were strong but below expectations.



What The Analysts Think

Cheaper sectors. Relative to today's market, in which the companies constituting the Forbes Sales 500 sell at 16.8 times latest 12-month earnings and 13 times estimated 1986 earnings, three sectors are available at discounts: utilities, consumer durables and finance. All sell at no more than 10.8 times estimated 1986 earnings.

Performance period	Average earnings per share	P/E
latest 12 months	$2.77	16.8
1986 estimates	3.59	13.0
1987 estimates	4.17	11.2

1	Consumer durables	$4.03	9.8	0.04%	-1.03%
2	Finance	3.58	10.8	-0.17	-0.21
3	Consumer nondurables	2.30	17.3	-0.28	-0.43
4	Utilities	3.37	9.9	-0.29	-0.45
5	Transportation	2.13	13.7	-0.62	-3.03
6	Technology	2.59	14.9	-0.88	-1.63
7	Energy	2.32	12.6	-1.57	-2.83
8	Capital goods	2.55	15.0	-1.59	-2.33
9	Raw materials	1.97	16.2	-1.66	-2.86

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continuously by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 5/20/86. Prepared by Wilshire Associates, Santa Monica, Calif., IBES, a service of Lynch, Jones & Ryan, New York.

What's a low-P/E investor to do when the market is trading at a lofty 18 times earnings? Bend the rules a little and settle for medium-low-P/E stocks.

Somewhat cheap

By Michael Ozanian

THE WAY TO BEAT the market over the long run, one school of thought holds, is to focus on stocks priced at small multiples of earnings per share. FORBES columnist David Dreman, one of the best-known practitioners of this school, has done repeated studies supporting the virtues of stocks that sell at low P/Es. He describes his latest findings on page 118.

Here we present the results of a slight variation on the low-P/E theory. We calculate the ratio not from latest 12-month earnings, as Dreman does (he puts little faith in earnings projections), but from analysts' estimates of 1986 earnings.

Does low-estimated-P/E investing

Price-to-hope ratio

All these issues sell for less than eight times hoped-for 1986 earnings, and most are expected to earn more this year than during the last 12 months. As important as the estimate, however, is the level of agreement among the analysts. The higher the agreement, the more likely that earnings will match expectations.

		Price		Latest 12-month	1986 estimates			Agreement among	1987 EPS	Sales
Exch	Company	recent	52-week high–low	EPS	EPS	P/E	number	analysts	est	($mil)
o	Chancellor	8¼	15¼– 5⅞	$2.18	$2.40	3.6	1	—	NA	$ 29
n	Chrysler	35⅛	47⅛–22½	8.95	6.37	4.2	25	average	$8.34	21,256
n	Downey Sav & Loan Assn	21	27 – 8⅛	5.99	4.67	4.5	1	—	4.67	297
n	Homestead Financial	18½	22⅛–10	3.30	4.00	4.6	3	very high	4.80	26
a	Engineered Sys & Devel	8⅝	18⅛– 8⅛	0.38	1.84	4.7	2	—	NA	40
o	First Federal Michigan	25¼	28⅛– 9⅛	7.43	5.32	4.8	5	low	5.48	1,115
n	TransCapital Financial*	16	19⅛– 8⅛	3.00	3.30	4.8	1	—	NA	362
o	Amer Fed S&L Colo	17¼	23⅛–13½	3.37	3.65	4.9	3	high	4.50	62
o	Commercial Federal	16⅞	19⅜– 5¼	3.24	3.44	4.9	3	low	3.84	303
n	Metropolitan Financial	17¼	22½– 9⅛	5.55	3.50	4.9	1	—	NA	169
o	Luskin's	7½	14½– 6¾	0.92	1.50	5.0	1	—	NA	110
n	Gibraltar Financial	11½	12¾– 5¼	2.13	2.20	5.2	12	low	2.21	1,028
n	Southmark	10	14 – 5⅛	2.05	1.89	5.3	2	—	2.04	573
n	Coleco Industries	15⅜	21½–14	3.03	2.90	5.3	10	low	4.27	776
o	Rocky Mount Undergarment	4¼	9¾– 3⅛	0.31	0.80	5.3	1	—	0.95	40
o	DCNY	47	55 –34	8.15	8.65	5.4	1	—	NA	240
o	Elbit Computers Ord	9	10⅜– 6⅞	1.44	1.60	5.6	4	average	1.60	149
n	Manufacturers Hanover	51	57⅛–33⅞	8.51	8.67	5.9	25	high	9.54	2,112
n	Far West Financial	15½	20⅛– 9⅛	3.19	2.67	5.9	1	—	NA	287
n	Great Amer First Sav Bank	18	19¾– 9⅝	2.82	3.02	6.0	9	average	3.31	874
a	Susquehanna	4½	5⅛– 3⅛	0.28	0.75	6.0	1	—	NA	111
n	CalFed	36	36 –16¾	6.62	5.97	6.0	14	average	6.32	1,962
n	Food Mocse	53⅛	56⅜–28⅛	8.99	8.66	6.2	25	average	8.27	52,774
a	American Fructose	11½	12⅛– 4½	0.17	1.70	6.8	1	—	2.50	128
n	Sea Containers Ltd	24⅛	43 –24	0.72	3.14	7.8	4	average	4.71	573

*Formerly Transohio Financial. NA: Not available. a: American Stock Exchange. n: New York Stock Exchange. o: over-the-counter.

Sources: The Institutional Brokers Estimate System (IBES), a service of Lynch, Jones, & Ryan via Micro/Scan Data on diskette from Isys Corp.; FORBES.

work? We don't have enough evidence to say. But we did try one five-year back-test of the approach, using two portfolios from 1981 with very high or very low P/Es, based on estimated 1981 earnings. From June 1981 to the present, a $1,000 investment in each of the 25 firms with estimated 1981 P/Es all greater than 36 grew to almost $34,000 (dividends not included), while the 25 stocks with P/Es all lower than 4.4 rose to $66,000. That's a 36% rise, vs. a 164% rise.

The consensus estimates on the following list of 25 potentially bargain-priced stocks come courtesy of the Institutional Brokers Estimate System. Our computer screened for companies selling at no more than eight times projected 1986 earnings, and it dropped firms with less than 15 cents a share in earnings over the latest 12 months or with a negative book value.

Although savings and loan associations have already gained 59% over the past 52 weeks, they still compose over one-third of our list of potentially cheap stocks. All of these shares sell for less than half the estimated 1986 market multiple of 13. (The market is trading at about 18 times trailing 12-month earnings.)

Allan Bortel, who tracks S&Ls for Shearson Lehman, observes, "Investors still remember getting burned in the early 1980s when interest rates rose and margins for S&Ls went to hell." But Bortel thinks adjustable rate loans have significantly helped these institutions hedge against interest rate risk. He expects that the 33 S&Ls he follows will eventually sell at about ten times projected earnings, up from a current 7.5. Among his favorites is American Federal Savings & Loan of Colorado, a company with fourth-quarter 1985 profits up 66% from the previous year.

Diane Heidt, an analyst with Drexel Burnham, is a little more cautious about the thrift industry. "These banks aren't completely immune to interest rate shifts," she warns. She cites CalFed (FORBES, *June 16*) as an example. "A one-point rise in interest rates would cost CalFed about 85 cents a share."

Wall Street expects Sea Containers, the world's largest lessor of ocean-shipping containers, to post a 336% jump between trailing 12-month and this year's estimated earnings. Then again, the company might not. The firm has high fixed costs in a cyclical industry. Should Sea Containers disappoint, it wouldn't be the first time. In 1981 analysts predicted 1982 earnings of $5.17 a share. The company proceeded to earn $3.56. ■

The Money Men

The cautious Bernard Klawans has beaten the stock market soundly over the past decade. He also knows how to save a penny or two on the overhead.

"For widows, orphans and me"

By Laura R. Walbert

WHY IS the Valley Forge Fund 90% in cash? Does manager Bernard Klawans know something we don't about the next bear market?

FORBES dropped in on the Wayne, Pa. headquarters to find out. Does Klawans talk to analysts? Nope, doesn't trust them. Does he get ideas from the *Wall Street Journal?* Financial magazines? Nope, they're a waste of time. Klawans (pronounced klah-WONZ) doesn't subscribe to any data services. He rarely takes ideas from brokers, and says most of his close friends are engineers, not investors.

There must be some research somewhere. "What's in all those file cabinets?" we ask. Klawans paws through old fund documents, SEC filings and tax information, coming to a folder marked "Shoes." Shoes? An industry report? "That's Mason shoes," says Klawans, yanking out a mail-order catalog. "I always buy the same shoes because they cost only $43 and they are the only shoes I've ever had that I didn't have to break in."

"I would buy their shoes, too, but they don't have my size," chimes in his wife, Nancy, from her seat at the typewriter.

Yes, the Valley Forge Fund, a no-load fund with $10 million in assets, is a true mom-and-pop operation. It's a bit eccentric, both in its investing and in its mode of operation. But it's hard to argue with the results. During the ten years ended Mar. 31, Valley Forge gained an average 17.5% a year, while the market was up 14% a year and the typical equity fund, 16.5%. And the fund hasn't had a down year since 1973. For that performance Klawans takes 1% a year.

While most mutual fund managers work in fancy downtown offices, Klawans, 65, wears a T shirt, shorts and thongs to work. Headquarters is the rec room of his home, with data storage in the garage and basement. When it's time for fund proxies to go out, the Valley Forge staff—the third member of which is a part-timer still in college—gets together to staple, stuff and stamp. Klawans figures he currently spends all of four hours a week on the fund.

As president of the fund, Klawans acts as the fund's custodian, trustee and transfer agent. Many funds charge hundreds of thousands of dollars for those services, but Valley Forge shareholders get them for free. When the fund buys new securities, Klawans jumps into a Chrysler station wagon, one of the fund management company's two major assets (the other is a minicomputer), and drives down to a safe deposit box at the Royal Bank of Pennsylvania.

Klawans handles all legal matters, does his own accounting and prices the fund. Just after 4 p.m., Klawans calls a broker for the closing prices on the fund's securities. Pulling a scrap of paper out of the wastebasket, Klawans jots down the changes, makes a few calculations, and reports, "Down a penny." That's the price that will appear in the next day's newspapers.

Besides running the fund, Klawans runs a computer business, acts as the transfer agent for the Royal Bank (which has 482 shareholders) and leases computer time to SmithKline